

Indiana Property Tax Revenues - The Challenges of Change

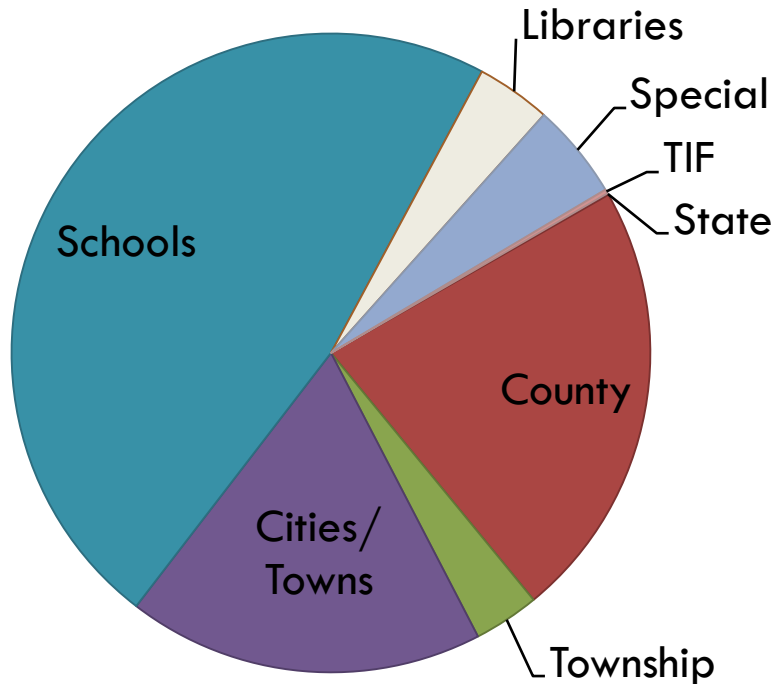
Prepared for the
Commission on State Tax and Financing Policy

Legislative Services Agency
August 27, 2007

Property Tax By Unit Type

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2007 Estimated Net Levy



| Local Unit | Dollars (In Millions) | Percent |
|-----------------|--------------------------|---------|
| Schools | \$2,923.7 | 48% |
| Counties | 1,375.8 | 22% |
| Cities/Towns | 1,113.3 | 18% |
| Special | 298.8 | 5% |
| Libraries | 233.0 | 4% |
| Townships | 205.0 | 3% |
| TIF Replacement | 12.8 | 0% |
| State | 5.5 | 0% |
| Total | \$6,167.9 | 100% |

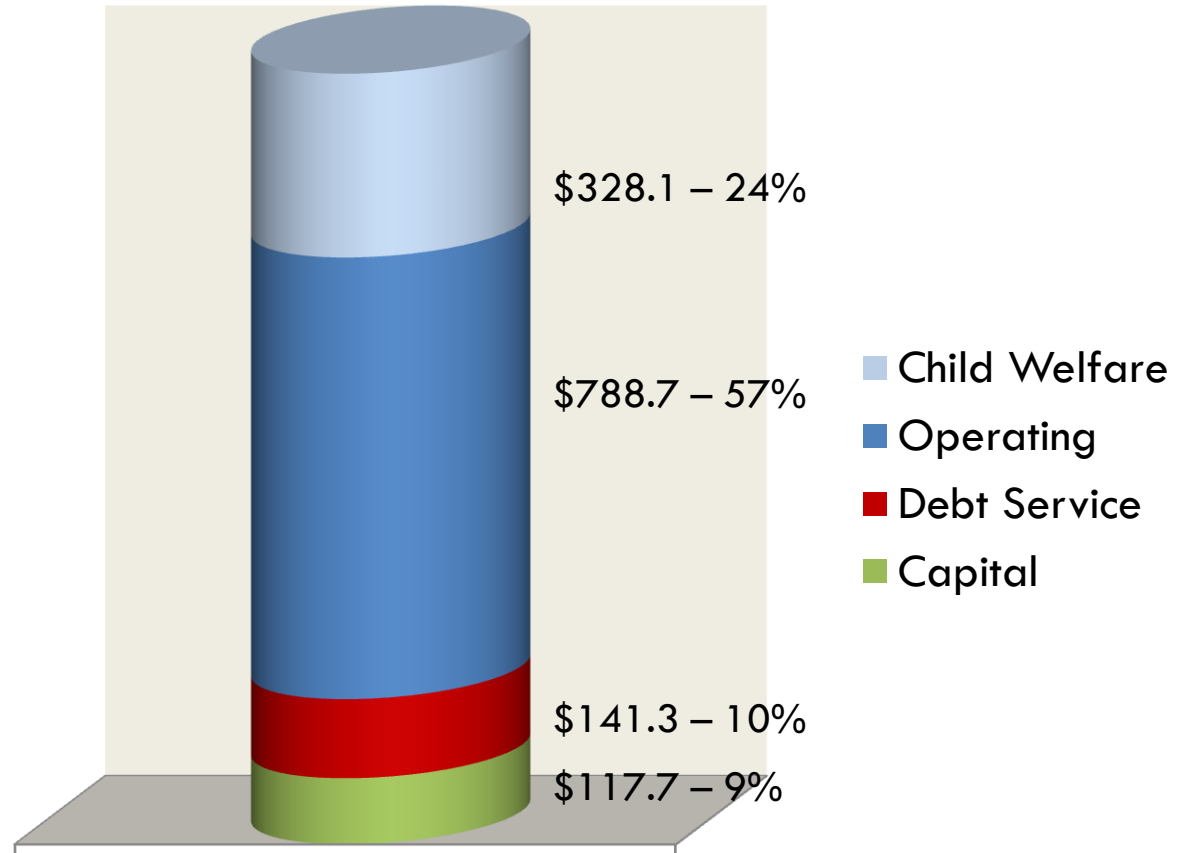
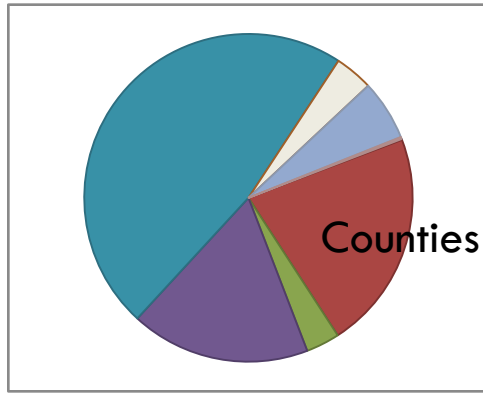
Property Tax Uses - Total

3

| Expense Category | 2007 Estimated Net Levy (In Millions) | Percent |
|------------------|---------------------------------------------|-------------|
| Operating | \$3,407.1 | 55% |
| Debt Service | 1,458.5 | 24% |
| Capital | 968.7 | 16% |
| Child Welfare | 328.1 | 5% |
| State | <u>5.5</u> | <u>0%</u> |
| Total | \$6,167 .9 | 100% |

Property Tax Uses - Counties

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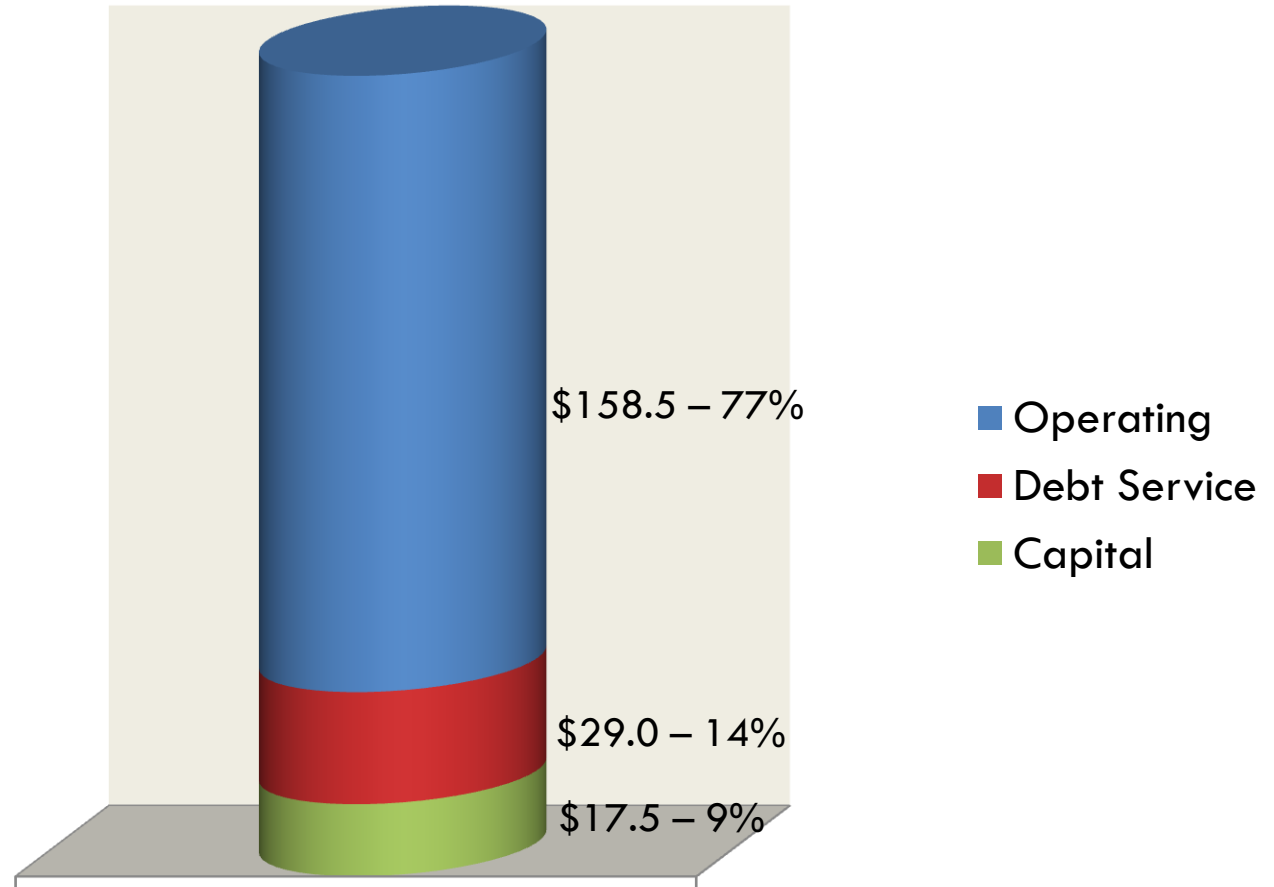
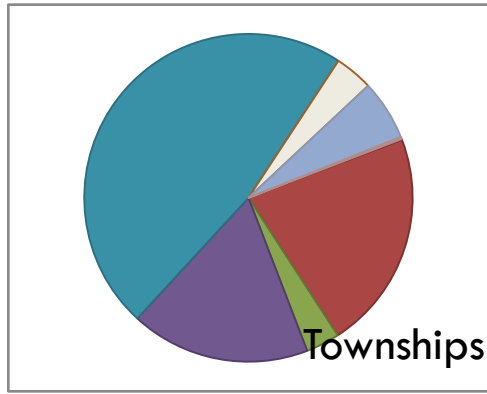


2007 Estimated Net Tax Levy

In Millions

Property Tax Uses - Townships

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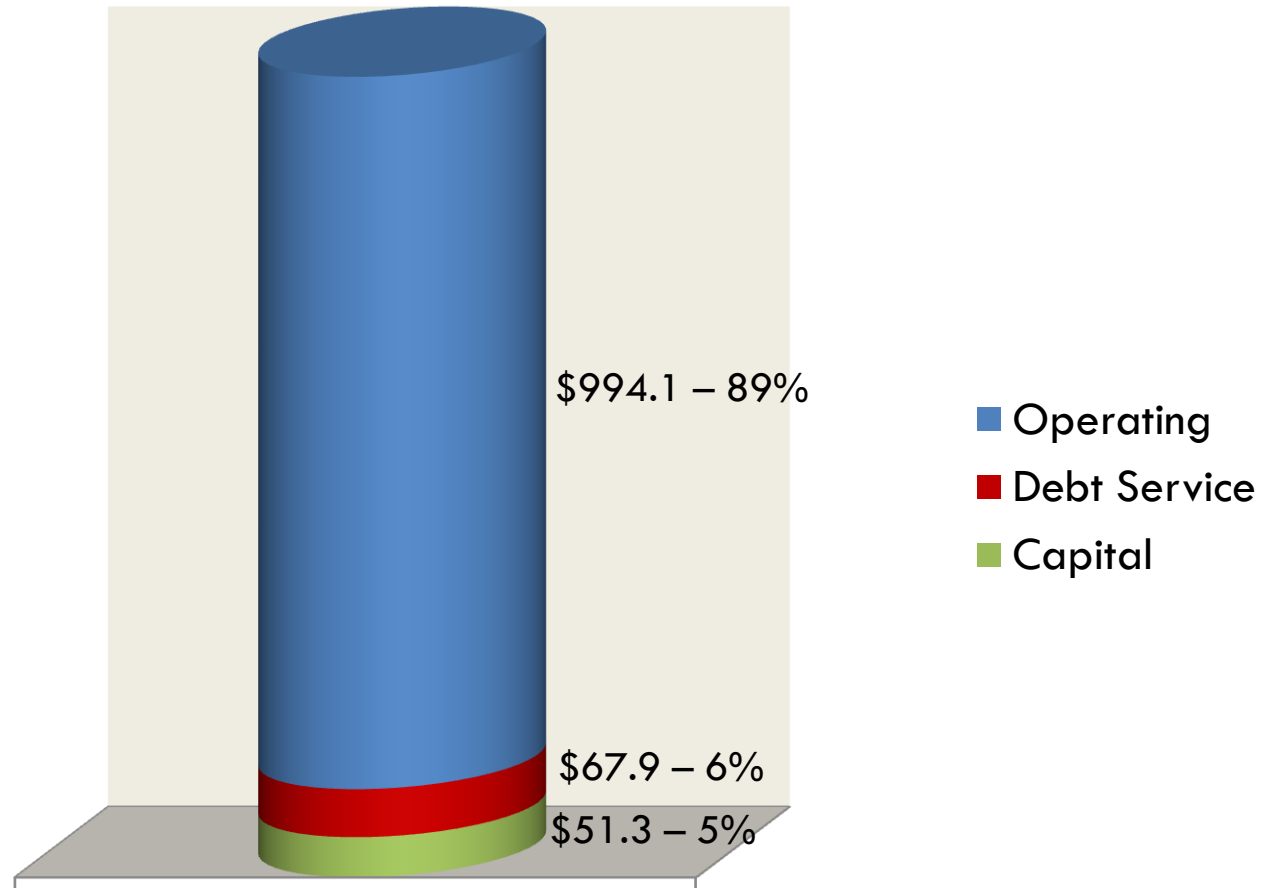
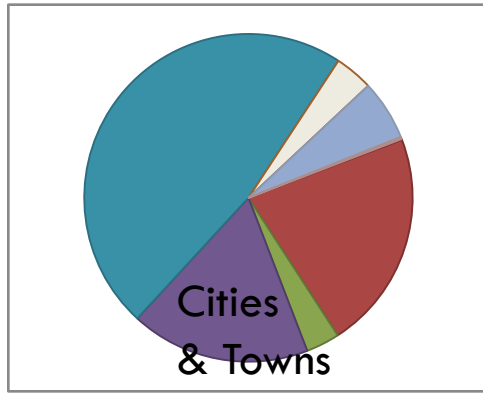


2007 Estimated Net Tax Levy

In Millions

Property Tax Uses – Cities and Towns

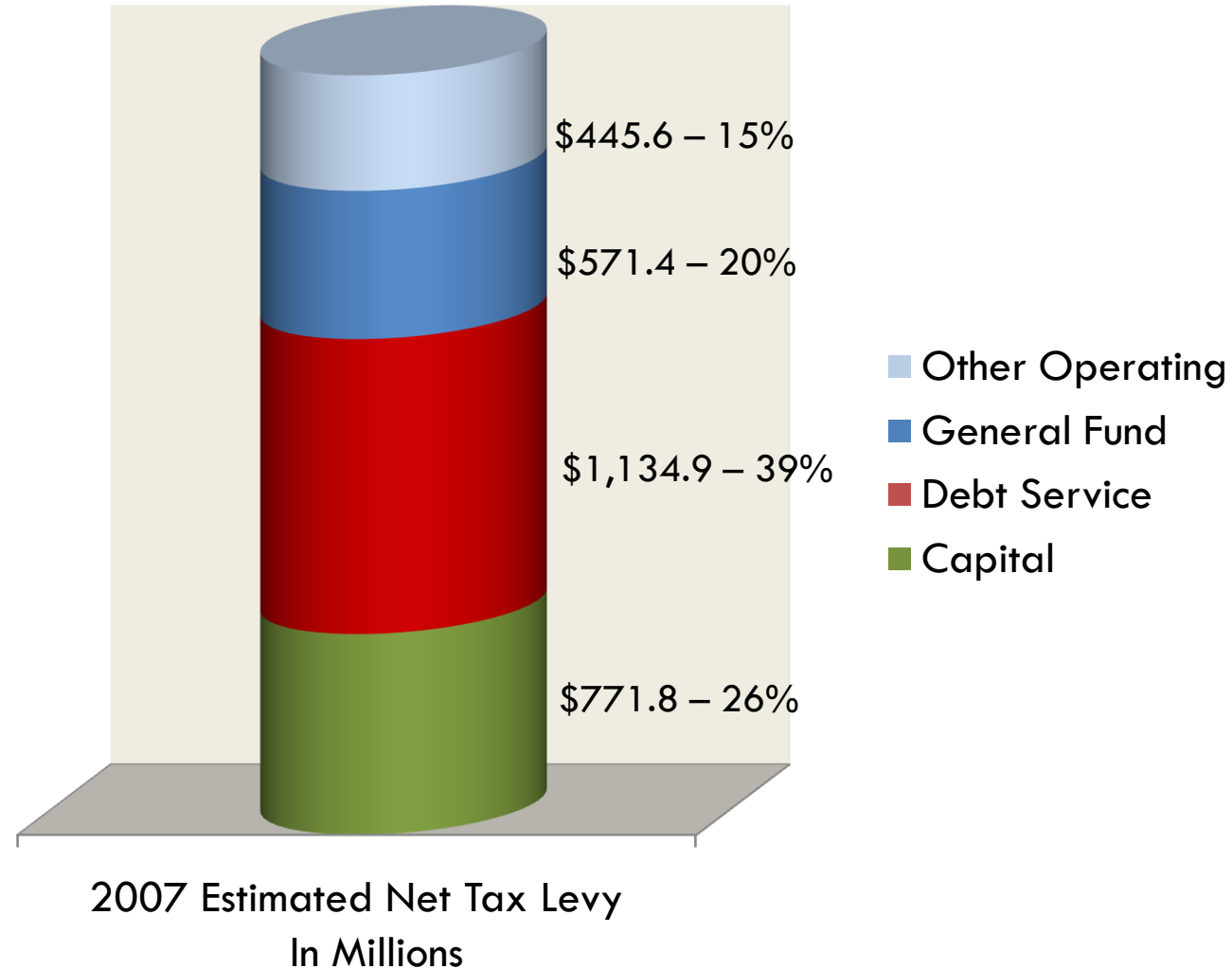
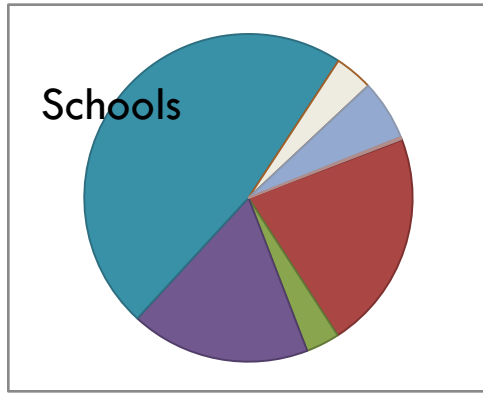
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2007 Estimated Net Tax Levy
In Millions

Property Tax Uses – Schools

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State Tax Revenue by Source

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FY 2007

\$5,423.5

- Sales Tax

\$4,580.4

- Individual Adjusted Gross Income Tax

\$746.4

- Corporate Adjusted Gross Income Tax

\$209.7

- Utility Receipts Tax

\$187.1

- Insurance Premiums Tax

\$76.4

- Financial Institutions Tax

Current Sales Tax Exemptions

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40+ exempt retail sales transactions



Wholesales sales



Double Direct – sales of goods directly used in direct production in manufacturing, farming, & public utilities



Food

Sales Tax on Services

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Expansion of existing tax base



Transition from goods to service economy



49 states tax services



Number of services taxed range from
1 to 168

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Prepared by Senator David Ford and Available on His Senate Website

Replacement of Property Tax Calculation (Million \$)

| | 2006 | Current | Proposed | Rate after | Approximate Revenue | Increased \$ Amount |
|----------------------------|-----------------|-------------|-----------------|-----------------|---------------------|---------------------|
| <u>Tax Type</u> | <u>Revenue*</u> | <u>Rate</u> | <u>Increase</u> | <u>Increase</u> | <u>Increase</u> | <u>Per 1%</u> |
| Sales Tax | 5,269.8 | 6% | 0.0% | 6.0% | - | 878.3 |
| Individual Income Tax | 4,322.2 | 3.4% | 0.0% | 3.4% | - | 1,271.2 |
| Corporate Adj.Gross Income | 703.2 | 8.5% | 0.0% | 8.5% | - | 82.7 |
| Financial Institutions Tax | 61.7 | 8.5% | 0.0% | 8.5% | - | 7.3 |
| Insurance Tax | 177.7 | 1.3% | 0.0% | 1.3% | - | 136.7 |
| Utility Receipts | 144.0 | 1.4% | 0.0% | 1.4% | - | 102.9 |
| TOTAL | | | | | - | |

| Property Tax (Pay 2006) | Gross Levy | PTRC | Net Levy | Homestead Credit | Final Net Levy |
|----------------------------|------------|---------|----------|---------------------|-------------------|
| | 7,821.1 | 1,804.3 | 6,016.8 | 362.5 | 5,654.3 |

Difference still needed to replace property tax dollar for dollar

\$ 5,654.3million

* Does not include income from one-time amnesty program.

Prepared by Sen. David Ford

Issues Related to Expanding Tax Bases

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- Surrounding States Rates



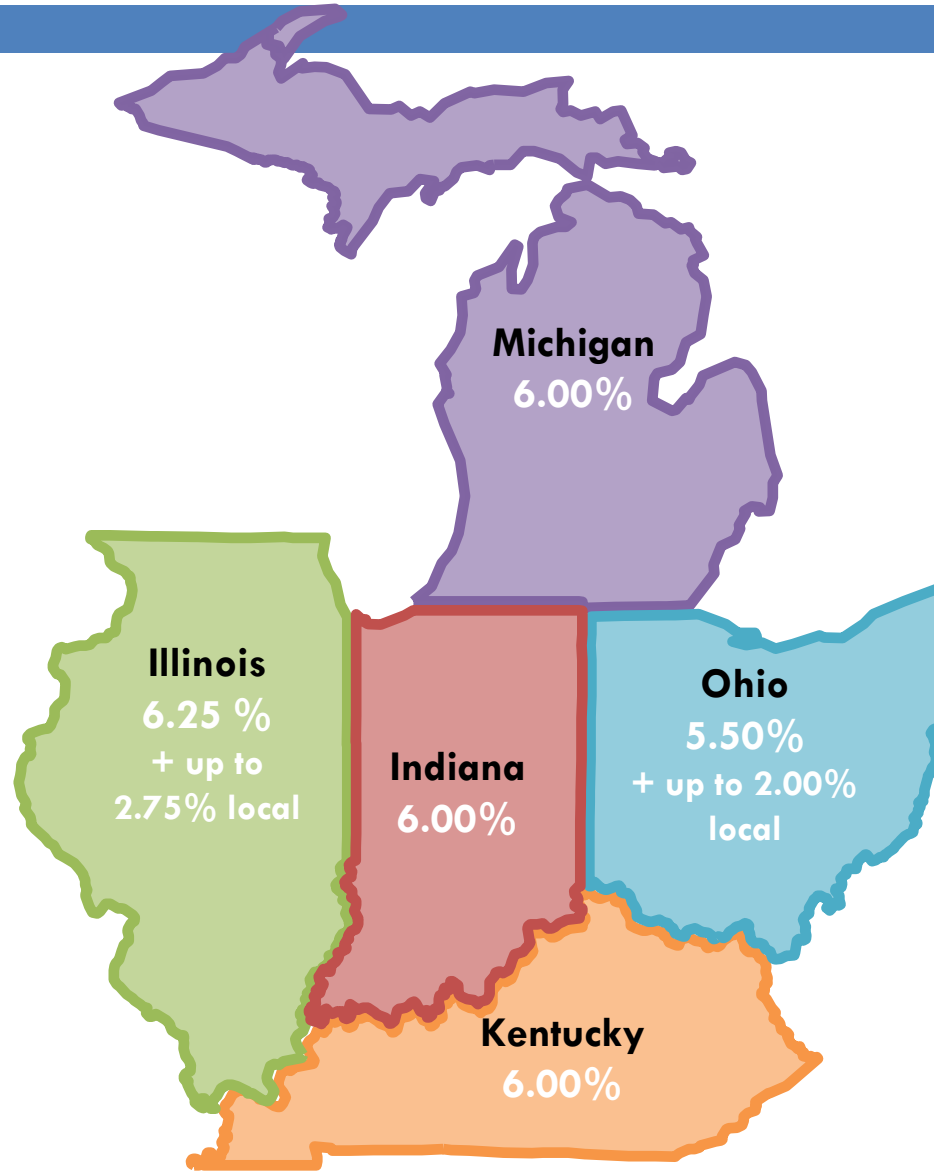
- Elasticity of Tax Base



- Interactive Effect of Multiple Tax Policy Changes

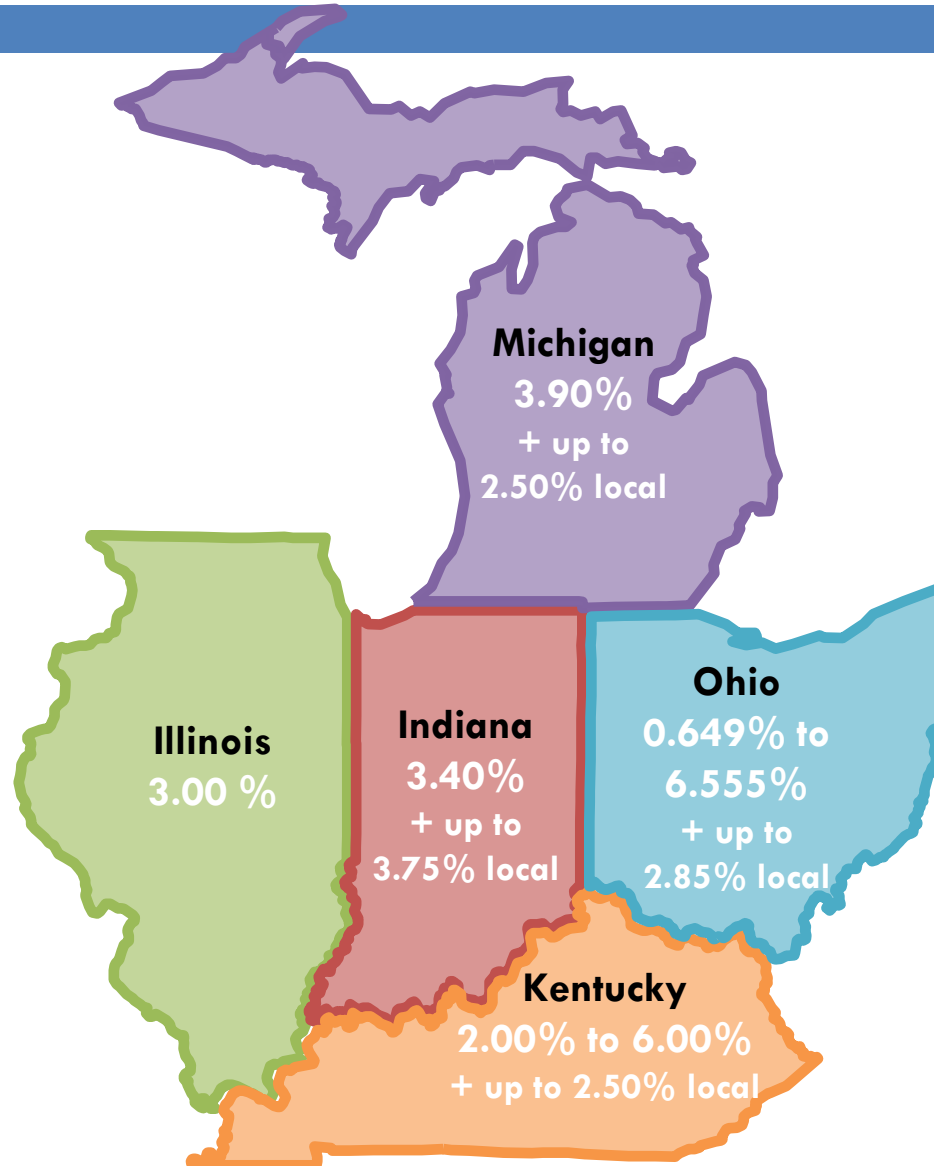
Sales Tax Rates

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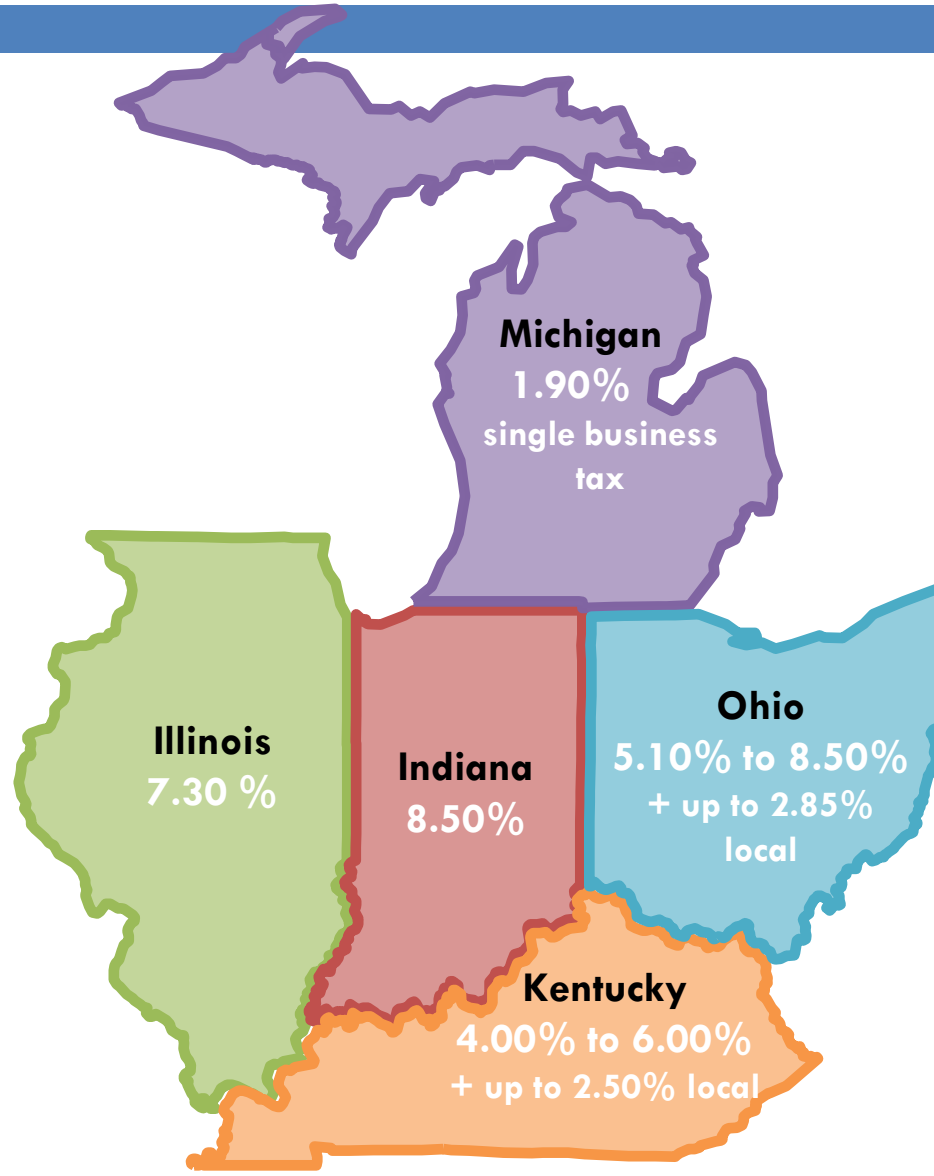
Individual Income Tax Rates

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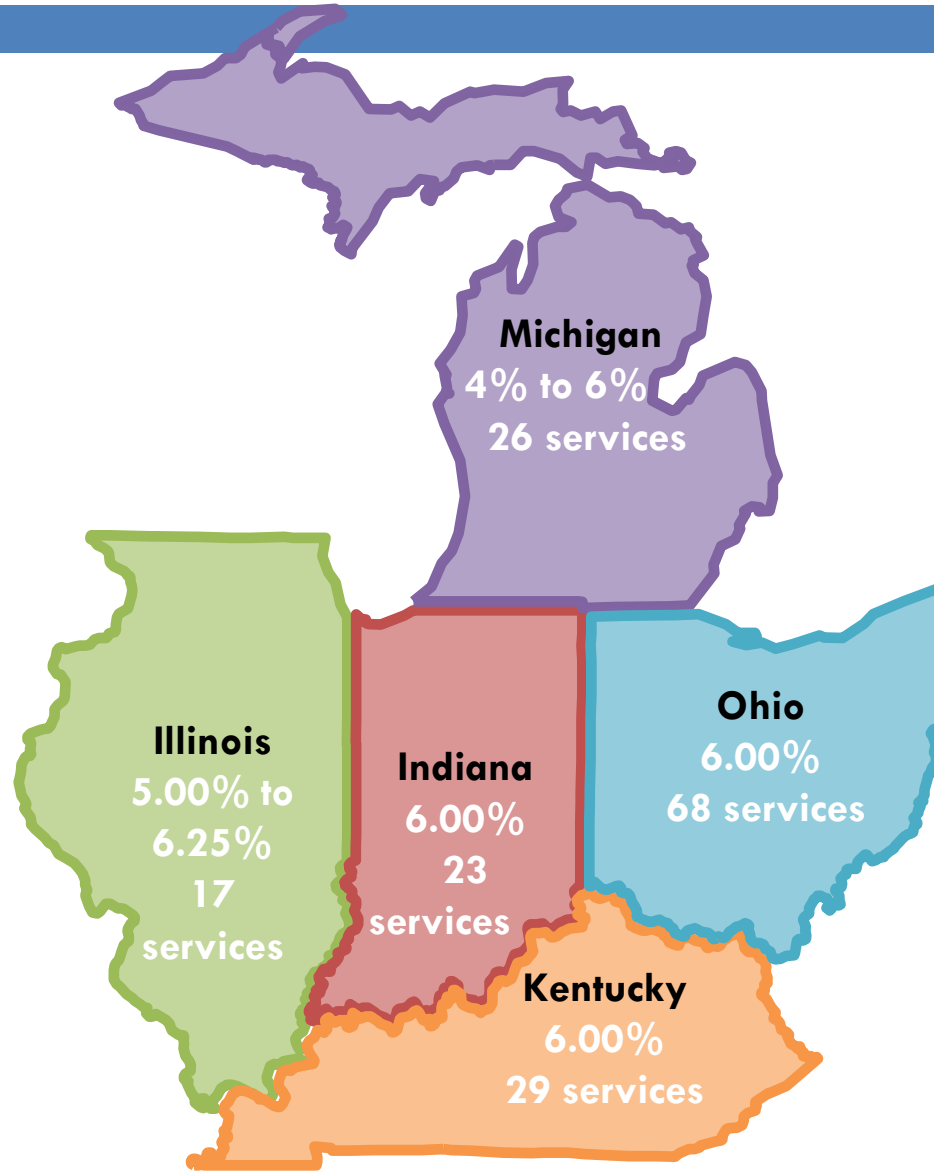
Corporate Income Tax Rates

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Sales Tax on Services

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Implications of Tax Rate Comparisons

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- Suggests only some responses rate increases.
 - ▣ Tax competitiveness issues.
 - ▣ Border area effects.
- Neglects other potential responses to rate increases.
 - ▣ Reductions in taxable consumption for various reasons.
 - ▣ Steering income to tax exempt or tax deferred activities.
 - ▣ Work versus leisure.
 - ▣ Shift in business organization – C-Corporations versus pass-through status.

Elasticity Concept

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- Quantifies the responsiveness of economic measures to other economic or policy changes.
 - ▣ % change in one economic measure for a given % change in another economic measure.
- Utilized to measure the response of a tax base to changes in statutory tax rates.
- Example: Tax rate elasticity of the sales tax base.
 - ▣ % change in taxable retail sales for a given % change in the sales tax rate.
 - ▣ Measures the behavioral response by consumers due to the increase in the after-tax price of goods.

Elasticity Concept - Example

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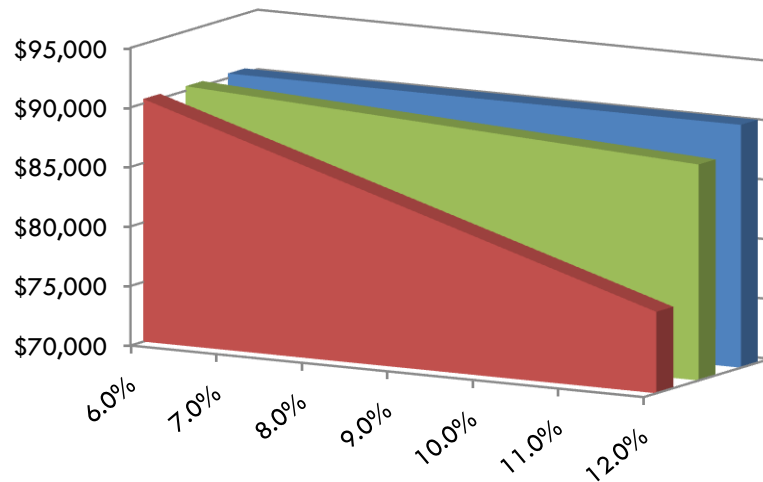
-- What is the potential yield from raising the sales tax rate from 6% to 7%? --

- If a behavioral response does not occur:
 - ▣ Revenue increases in proportion to the rate increase of 16.7%.
- If a behavioral response does occur:
 - ▣ Revenue increases by less than 16.7% as the sales tax base shrinks.
 - Consumer budget constraints
 - Necessities vs. luxuries
 - Leakage – border effect, catalog sales, internet sales

Elasticity of Sales Tax

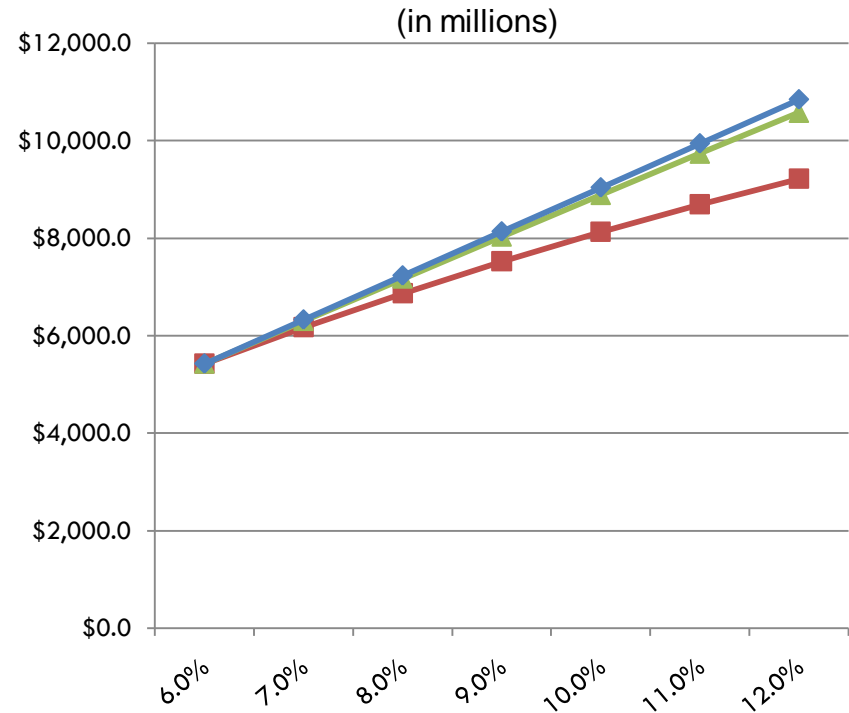
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□ Sales Tax Base Response (in millions)



- HIGH Responsive Sales Tax Base
- LOW Responsive Sales Tax Base
- Unresponsive Sales Tax Base

□ Sales Tax Revenue Response (in millions)

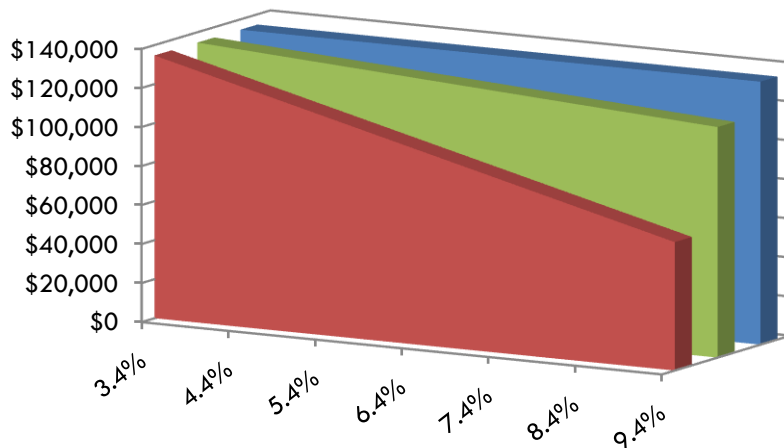


- Yield from HIGH Responsive Sales Tax Base
- Yield from LOW Responsive Sales Tax Base
- Yield from Unresponsive Sales Tax Base

Elasticity of Individual Income Tax

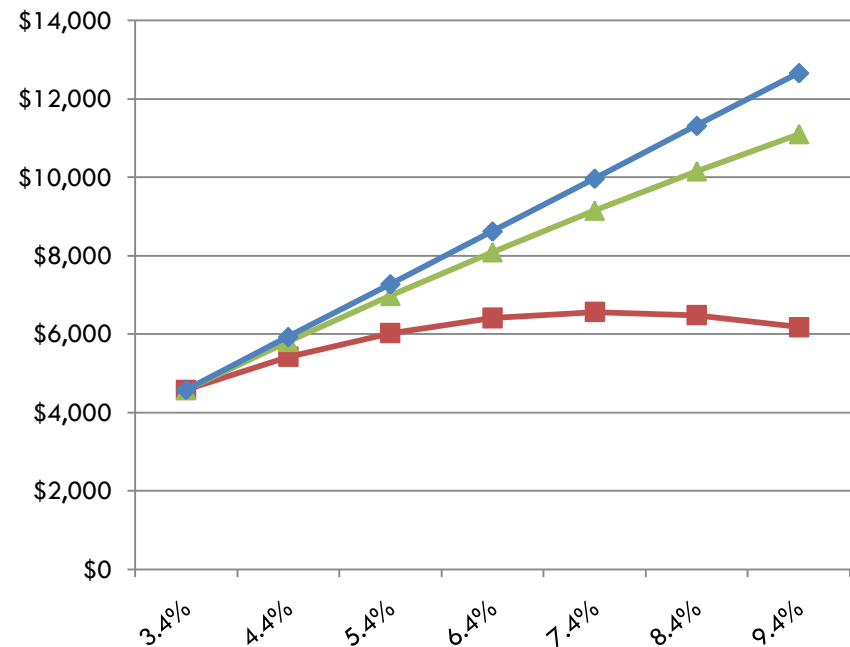
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Income Tax Base Response (in millions)



- HIGH Responsive Individual AGI
- LOW Responsive Individual AGI
- Unresponsive Individual AGI

Income Tax Revenue Response (in millions)

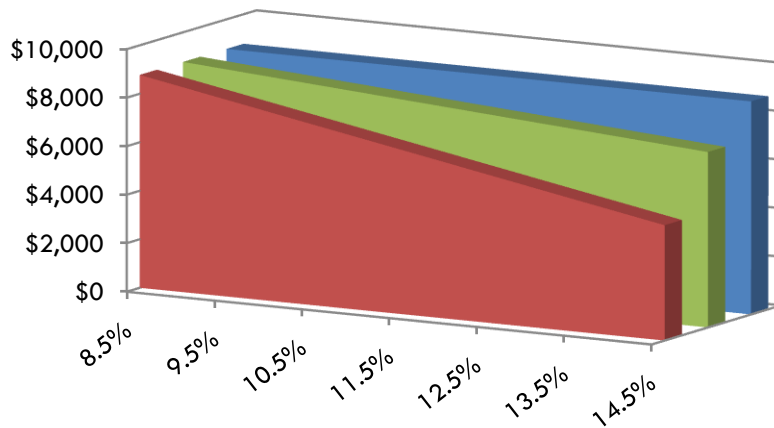


- Yield from HIGH Responsive Individual AGI
- ▲ Yield from LOW Responsive Individual AGI
- ◆ Yield from Unresponsive Individual AGI

Elasticity of Corporate Income Tax

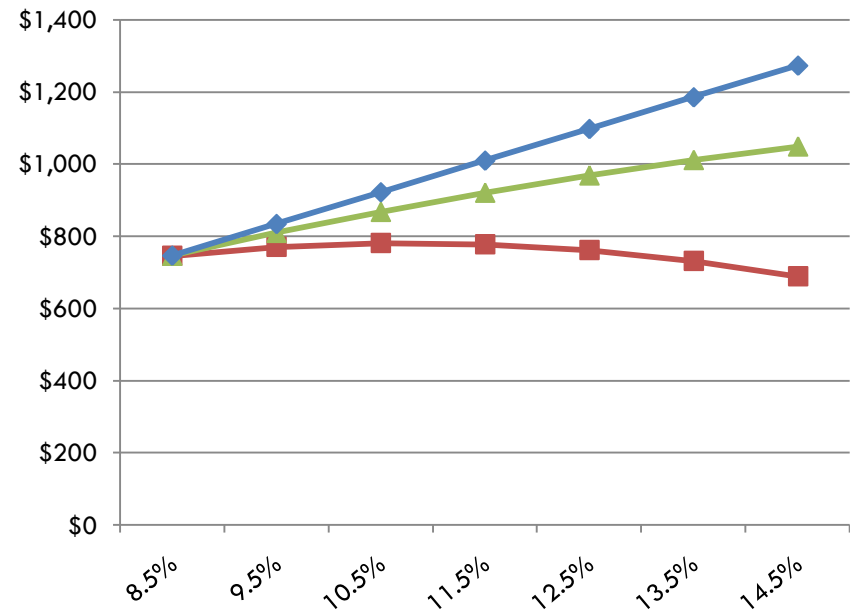
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Corporate Tax Base Response (in millions)



- HIGH Responsive Corporate AGI
- LOW Responsive Corporate AGI
- Unresponsive Corporate AGI

Corporate Tax Revenue Response (in millions)



- Yield from HIGH Responsive Corporate AGI
- Yield from LOW Responsive Corporate AGI
- Yield from Unresponsive Corporate AGI

Interactive Effects

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- Tax base elasticity estimates.
 - ▣ Are estimates of the aggregate response to tax rate increases.
 - ▣ Assume all other policies are unchanged.
- What happens if property taxes are replaced?
 - ▣ The aggregate tax base response could change when combined with property tax reductions.
 - ▣ Individual responses will vary depending on individual differences in income, consumption patterns, and property tax burdens.

Revenue Given Tax Base Response

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| Sales Tax | | | |
|-----------|------------|--------------------------|-------------------------|
| Tax Rate | % Increase | HIGH Responsive Tax Base | LOW Responsive Tax Base |
| 6.0% | | | |
| 7.0% | 16.7% | \$745.7 | \$877.6 |
| 8.0% | 33.3% | \$1,446.3 | \$1,747.6 |
| 9.0% | 50.0% | \$2,101.6 | \$2,610.1 |

| Individual Income Tax | | | |
|-----------------------|------------|--------------------------|-------------------------|
| Tax Rate | % Increase | HIGH Responsive Tax Base | LOW Responsive Tax Base |
| 3.4% | | | |
| 4.4% | 29.4% | \$841.6 | \$1,225.1 |
| 5.4% | 58.8% | \$1,453.4 | \$2,394.8 |
| 6.4% | 88.2% | \$1,835.3 | \$3,509.0 |

| Corporate Income Tax | | | |
|----------------------|------------|--------------------------|-------------------------|
| Tax Rate | % Increase | HIGH Responsive Tax Base | LOW Responsive Tax Base |
| 8.5% | | | |
| 9.5% | 11.8% | \$24.0 | \$63.3 |
| 10.5% | 23.5% | \$34.6 | \$121.4 |
| 11.5% | 35.3% | \$31.8 | \$174.3 |

Sales Tax on Services

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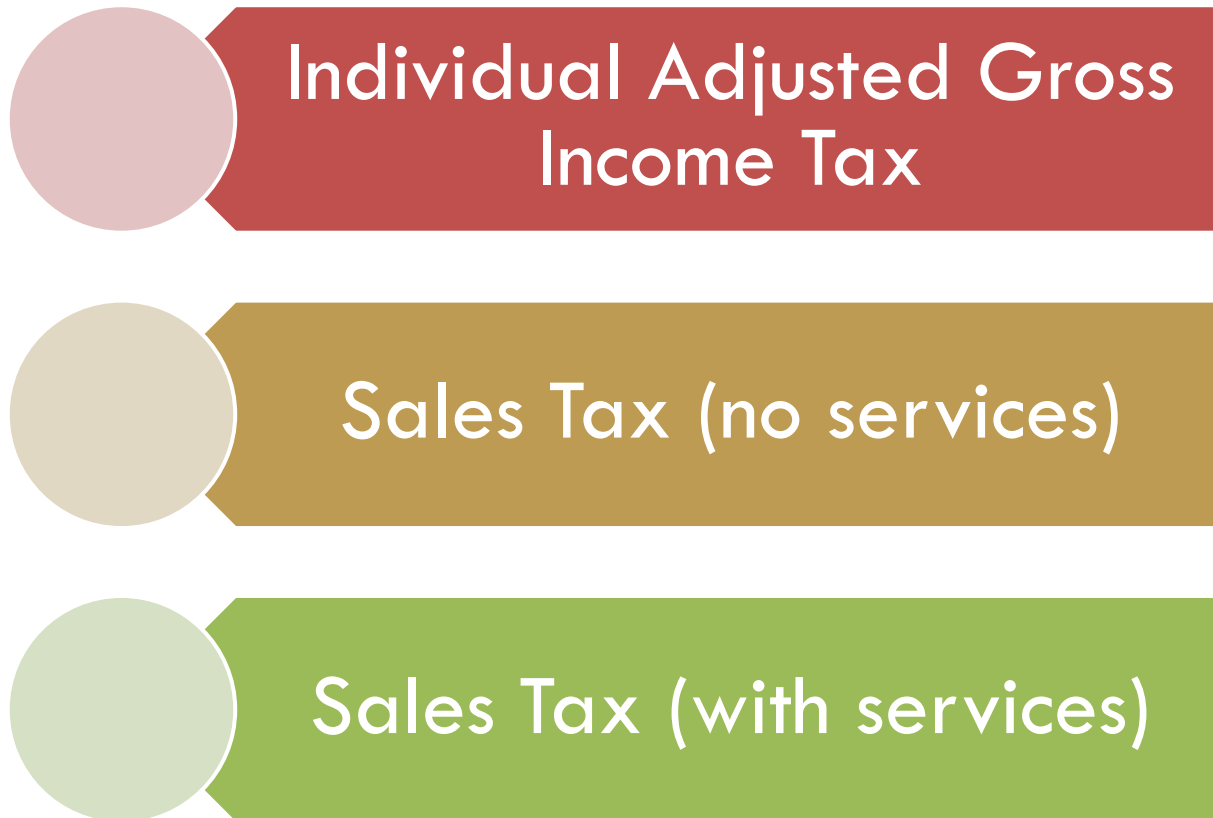
**Estimated increase in sales tax revenue for
each 1% increase in tax rate.**

| Sales Tax Rate on Services | Additional Sales Tax Revenue |
|----------------------------|------------------------------|
| 1% | \$176.6 |
| 2% | 349.1 |
| 3% | 517.7 |
| 4% | 682.2 |
| 5% | 842.8 |
| 6% | 999.3 |

Property Tax Replacement Options

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Three Revenue Scenarios for FY 2007



Individual Income Tax Rate

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Scenario for FY 2007

Current Individual Adjusted Gross
Income Tax Rate: 3.4%

Replace 50% of Levy

New Total Tax Rate: 6.0%

Additional Rate: 2.6%

Additional Revenue: \$3,070

Replace 100% of Levy

New Total Tax Rate: 9.0%

Additional Rate: 5.6%

Additional Revenue: \$6,146

CY 2007 Estimated Net Property Tax Levy = \$6,168

Sales Tax Rate Increase

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Scenario for FY 2007

Current Sales Tax Rate: 6.0%

Replace 50% of Levy

New Total Tax Rate: 9.5%

Additional Rate: 3.5%

Additional Revenue: \$3,039

Replace 100% of Levy

New Total Tax Rate: 13.2%

Additional Rate: 7.2%

Additional Revenue: \$6,150

CY 2007 Estimated Net Property Tax Levy = \$6,168

Expansion of Sales Tax to Services

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Scenario for FY 2007

Current Sales Tax Rate on Services:
N/A

Replace 50% of Levy

New Total Tax Rate: 8.0%

Additional Rate: 2.0%

Add'l Nonservice Revenue:
\$1,748

Add'l Service Revenue: \$1,300

Replace 100% of Levy

New Total Tax Rate: 11.1%

Additional Rate: 5.1%

Add'l Nonservice Revenue:
\$4,397

Add'l Service Revenue: \$1,736

CY 2007 Estimated Net Property Tax Levy = \$6,168

Other Fiscal and Legal Matters

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Administrative Cost of
the Assessment System



Bonds Supported by
Property Tax Revenue



Legal Issues

State and Local Administrative Expenses

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- 
- \$73.5 M Avg. Local Costs (2001-2005)

- 
- \$4.4 M Avg. State Costs

- 
- 1.5% of Net Property Tax Collections

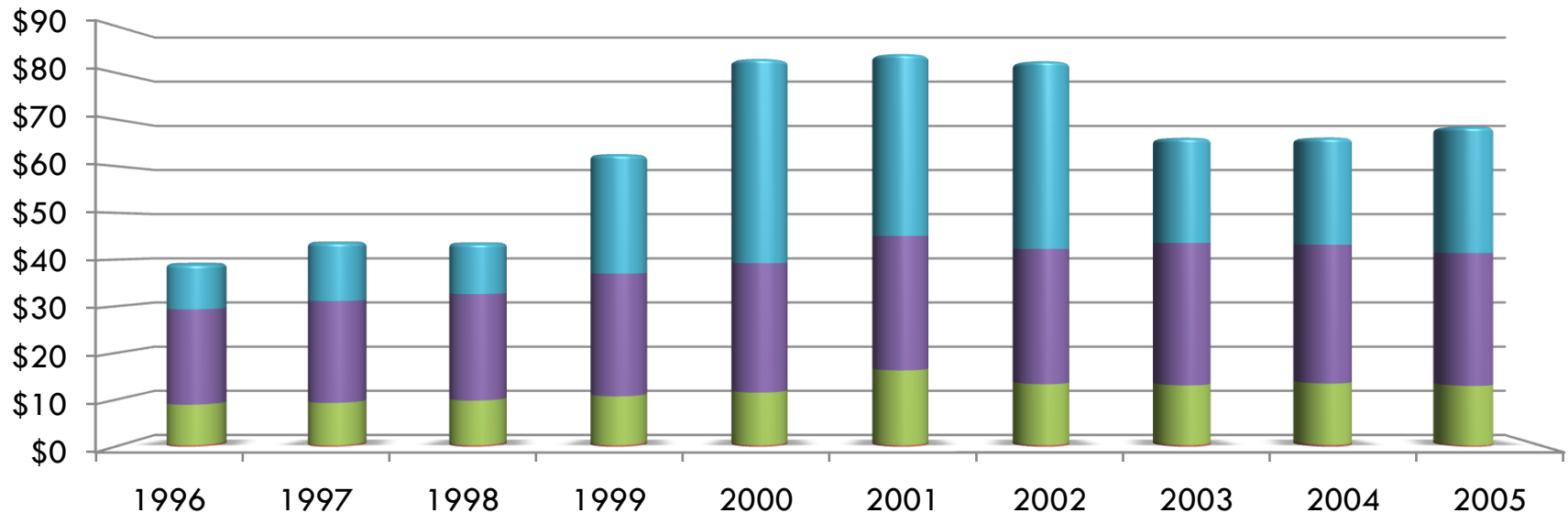
Local Administrative Expenses

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Assessment System Appropriations

(includes additional appropriations)

In Millions

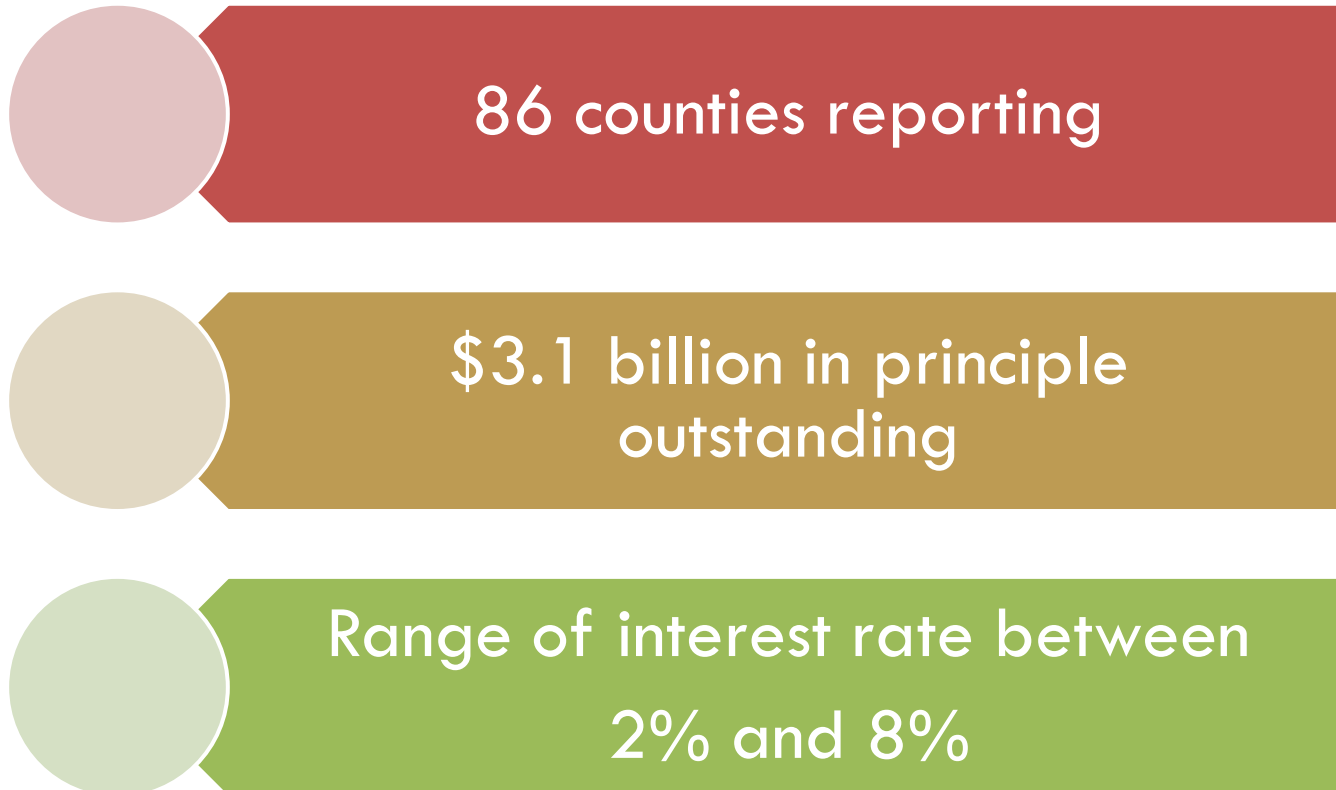


- Reassessment Fund
- Township Assessor
- County Assessor
- Board of Review
- Tax Adjustment Board

Bonds Supported by Property Taxes

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**Based on 2005 Local Unit Self-Report to
the Department of Local Government Finance.**



Other Fiscal and Legal Issues

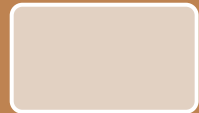
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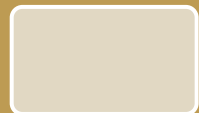
Contract with bond holders



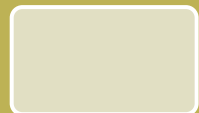
Collection of special assessments



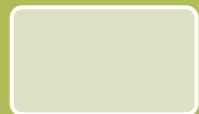
Effective federal income tax rate



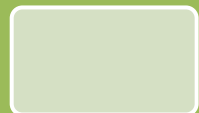
Impact on borrowing costs



Calculation of debt



Calculation of revenue



Transition Issues

Summary

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2007 Estimated Net Property Tax Levy



Major Sources of State Revenue



Issues Impacting Expansion of Tax Bases



Scenarios to Replace Part or All of
Property Taxes



Other Fiscal and Legal Issues